This record is a partial extract of the original cable. The full text of the original cable is not available.

091036Z Feb 04

C O N F I D E N T I A L SECTION 01 OF 04 ANKARA 000763

SIPDIS

STATE FOR EB/IFD, EUR/SE
TREASURY FOR OASIA - JLEICHTER AND MMILLS
NSC FOR MBRYZA AND TMCKIBBEN
BUDAPEST FOR SUDMANN

E.O. 12958: DECL: 01/19/2009
TAGS: ECON PGOV TU
SUBJECT: ROCKY TRANSITION AT BANK REGULATORY AGENCIES AS BANKS FACE A CRITICAL YEAR

REF: ANKARA 464

CLASSIFIED BY ECONOMIC COUNSELOR SCOT MARCIEL FOR REASONS 1.5 (B) AND (D).

¶1. (C) Summary: Following the resignation of former BRSA/SDIF Chairman Akcakoca and the passage of legislation separating the two bank regulatory institutions, these agencies are in transition to new management and a new structure. By all accounts, it is shaping up as a difficult transition, with most management being replaced, doubts about the quality of the new people, and open questions regarding coordination between the newly-separated agencies. IMF staff and other post contacts are concerned, both about the disarray at bank regulatory agencies and other banking sector issues, such as the absence of progress towards state bank privatization. Many post contacts also expressed concern about the timing of these problems, given the likelihood that 2004 will be a critical year for the still-vulnerable banking sector as interest rates and inflation fall. End Summary.

2004 Expected to be Critical Year for Banking Sector...
--- ----------

¶2. (Sbu) 2004 is shaping up to be a critical year for Turkish banks. Many of post's banking contacts agree that the sector, though far less vulnerable than it was at the time of the 2001 crisis, is not out of the woods. Though banks now meet capital adequacy requirements, particularly after a profitable 2003, much of their capital is tied up in real estate and loans to group companies. Moreover, as several Istanbul bankers and analysts confirmed to econoffs, banks'--especially state-owned banks'--profitability largely derives from their massive holdings of government securities. Current capital adequacy rules encourage banks to hold government securities because, unlike loans, these securities require no capital allocation. Turkish Bankers Association Secretary General Ekrem Keskin said that banks are

SIPDIS
effectively subsidizing their unprofitable loan business with profits from government securities.

¶3. (Sbu) With inflation and interest rates falling sharply, and projected to fall into the teens in 2004, there is widespread concern bank profitability will fall. Policymakers hope that banks will put greater emphasis on developing traditional banking activities. Central Bank Vice Governor Sukru Binay told econoffs he is working with the accountants association to try to get small and medium-sized businesses to develop audited financial statements to facilitate access to bank credit. But several bankers and one regulator told econoffs that there is limited room for growth in corporate lending given unreliable financial statements, the relative absence of good credits, and a tax and regulatory regime that inhibits loan growth. Though Keskin praised the GOT's elimination of the stamp duty as part of an IFI-inspired campaign to reduce intermediation costs, these costs remain high, inhibiting loan growth and driving transactions offshore. Consumer and credit card loans have shown strong growth in late 2003, but corporate loan growth is weaker. Economist and Yapi Kredi Bank board member Hassan Ersel told econoff loan growth is weak enough to be a potential constraint on GDP growth.

¶4. (C) Binay, some Istanbul analysts, and Treasury domestic debt management official Volkan Taskin, have all told econoffs that banks are incurring asset-liability mismatches, both in terms of currency and maturity, though Taskin said

the mismatches were within the limits allowed by regulators. In other words, low-interest rate foreign currency deposits are being used to fund high-interest rate TL government securities, and short-term deposits are also being used to fund long-term Eurobond holdings. Though many of these same contacts pointed out that the banking system's huge foreign currency-denominated deposits (USD 45 billion) could help Turkey weather a sharp fall in the exchange rate, a market correction could cause problems in the banking sector as banks take sudden losses on their positions.

..Yet Banking Reforms Have Stalled

¶5. (C) Meanwhile, the IFI's are frustrated over stalled banking sector reforms. IMF Deputy Resrep Christoph Klingen. Klingen told us recently that the IMF and World Bank banking experts were wondering whether they were "back to square one, or at minus one." Given the lack of progress on a range of banking sector issues, the IFI's are rethinking their strategy.

Rocky Transitions at Bank Regulatory Agencies

¶6. (C) First and foremost among IFI and other contacts' concerns are the management changes at the newly-separated bank regulatory agencies: BRSA and SDIF. The GOT pushed for the separation, most likely as a way of appointing an entirely new SDIF board, thereby strengthening its control over the SDIF's sensitive management of intervened banks and their assets. The IMF went along with the separation of the two boards, on condition that the new board members be well-qualified. On January 14, the GOT announced its candidates for the new SDIF board. The GOT's candidate for chairman was Abdullah Soysal. Soysal, like recently-appointed BRSA Chairman Tevfik Bilgin, is a former on-site bank inspector (sworn auditor) who also has bank management experience. A week later, however, the appointments of Soysal and one other board candidate were rejected by President Sezer. Soysal had been a manager of Interbank, a bank that later failed and had to be taken over by SDIF. The GOT subsequently proposed Ahmed Erturk, a member of the Capital Markets Board and former Al-Baraka Turk manager, to be chairman, and Erturk assumed the SDIF chairmanship on January 29.

¶7. (C) Klingen said that not only the Chairmen but also the Vice Presidents, and possibly one layer below that, will be changed at the two regulatory bodies. The new people seem to be less independent-minded and less qualified than their predecessors. Klingen pointed out that there are many unresolved questions about how the newly-separate BRSA and SDIF will work with each other, particularly since in the past SDIF relied on BRSA in many areas. Klingen raised the possibility of a separate asset management agency.

¶8. (C) It is striking that five of the seven SDIF board candidates originally proposed by the GOT are former sworn auditors. Recently-removed BRSA Vice President Fikret Sevinc told econoff that BRSA Chairman Bilgin was very close to the network of sworn auditors, who tended to keep their distance from other BRSA and SDIF officials, thereby exacerbating communication and coordination problems at BRSA. Central Bank officials and the IMF Deputy Resrep have confirmed that the sworn auditors are a close-knit faction, and the IMF Deputy Resrep said the IMF has been trying to dilute the sworn auditors "monopoly" on bank inspection.

¶9. (C) BRSA and SDIF are also reeling under multiple investigations looking for corruption: SDIF V.P. Berberoglu recently told econoff that forty-odd investigators--from parliament, the prime ministry and other investigative bodies--are swarming over SDIF and BRSA, questioning myriad prior decisions.

Failure of SDIF Asset Tender:

¶10. (C) Another IFI concern relates to the effective death of the SDIF asset sales program. Sevinc characterized estimates of as much as USD 50 billion for the value of the SDIF's portfolio of seized assets as wildly inflated, the result of a provision in Turkey's bankruptcy law that uses 200 to 300 percent interest rates to value assets. Sevinc said this provision was left over from Turkey's hyperinflation days, when bankers wanted to avoid having the value of their assets

inflated away during lengthy bankruptcy proceedings. In reality, Sevinc estimated the value of SDIF's portfolio at about USD 3 billion, which helps explain the recent failure of SDIF's tender of non-performing loans (NPL's).

¶11. (C) A U.S. Treasury Technical Advisor, who had been working with SDIF on the asset sales program, told econoff that the program had succeeded in attracting serious bidders: Deutsche Bank, Morgan Stanley, and Credit Suisse, among others, bid on the package with a book value of USD 320 million. The advisor felt that Price Waterhouse, retained by SDIF, had done a good job in valuing the NPL's at USD 30-80 million. However, SDIF's board--which knew it was about to be replaced--then set a "reserve price" of over USD 100 million, below which they would not sell. When the high bid came in at USD 53 million, the SDIF board cancelled the bid. The U.S. Treasury advisor believes that the bid--at almost 17 percent of book value--approaches U.S. FDIC's historical results and should have been accepted. His advisor colleagues and the IMF agree. All agree that this result effectively ends the asset sales program for the time being, since no financial house will take the time and expense of bidding in the future. The failure of the SDIF tender, like that of some recent privatizations, points to the need for protection from prosecution for government officials for their official decisions. Klingen said whenever the IMF raises this issue, the GOT says it is too difficult to take on.

Failed Bank Owners' Try to Return to Sector

¶12. (C) The IFI's and many analysts are also perturbed by two recent attempts by former owners of failed banks to regain control of their old banks. Econoff asked SDIF V.P. Berberoglu about press reports that Cukurova Group was trying to: a) restructure its debts to SDIF, and b) take back control of Yapi Kredi Bank. Note: At the same time, Cukurova was part of a consortium bidding on the privatization of the state oil refiner, Tupras, though this consortium has lost out to a competing bidder. End Note. Berberoglu confirmed that Cukurova had indeed written to SDIF proposing to pay a smaller amount to SDIF on both Pamuk and Yapi Kredi, in return for a much shorter repayment period. As for rumors that Cukurova is trying to reassert control over Yapi Kredi Bank, Berberoglu agreed that this would appear to be a violation of the Banking Act's requirement that no executive of a previously-failed bank be allowed to have a banking license.

¶13. (Sbu) On January 26, BRSA/SDIF Chairman Bilgin announced that SDIF had rejected Cukurova's offer as not in compliance with the law. In his public statement, however, Bilgin left open the possibility that SDIF might entertain other proposals from Cukurova in the future, and there continue to be rumors in financial markets that Cukurova will make another attempt to get back into Yapi Kredi.

¶14. (C) The other, more immediately troublesome case relates to the SDIF-ousted former owners of Demir and Kent Banks. Klingen lamented the legal can of worms opened by a court decision to overturn SDIF's earlier takeover of Demir and Kent. One of the earlier IMF reforms was to have all bank regulatory cases heard by a single chamber of the Council of State (Danistay), so as to have all cases heard by a judge with banking expertise. This chamber had upheld SDIF's takeover of Demir and Kent, but on appeal the decision was overturned by the General Assembly of the Danistay. Next steps on the Demir and Kent cases are unclear, according to Klingen, with even the legal experts of the BRSA/SDIF unsure what can be done. If the cancellation of the takeover stands, it could imperil SDIF's subsequent sale of Demir to HSBC, one of the few large foreign investments in Turkey in recent years.

State Banks Grow Larger Amid Delays on Privatization

¶15. (C) World Bank Country Director Andrew Vorkink recently told Econcouns he sees little prospect that the State Banks will be privatized soon. There have been several public hints in recent weeks that the GOT and state bank management are not expecting to privatize the state banks in the near future. According to Keskin of the Bankers' Association, Prime Minister Erdogan recently told a meeting of AK Party parliamentarians that, when the blanket deposit guarantee is phased out this summer, people with worries about private banks could shift deposits to state banks. Keskin worried about phasing out the blanket guarantee while some banks

remain under state ownership. Meanwhile, the Managing Director of state-owned Ziraat Bank has been talking about his strategy for the year, giving no indication that the bank might be privatized. At the same time, Ziraat's deposit base has been enlarged by virtue of the transfer of failed Imar Bank's deposits to Ziraat, and Halk Bank may be enlarged by a possible merger with SDIF-intervened Pamuk Bank.

Comment:

¶16. (C) Since coming to power, GOT actions have suggested both a strong desire to gain control of the independent bank regulatory agencies and a reluctance to move ahead on state bank privatization. As the banking sector faces a crucial transition year, the GOT does not seem to be sensitive to the risks to the sector stemming from the disarray at the regulatory agencies and the absence of progress on bank privatization.

EDELMAN